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**AUTHOR:**

Dr. Chad Damro  
Senior Lecturer of Politics and International Relations  
Co-Director, Europa Institute  
University of Edinburgh  
21 George Square  
Edinburgh EH8 9LD  
[Chad.damro@ed.ac.uk](mailto:Chad.damro@ed.ac.uk)  
Tel: +44 131 650 6698  
Fax: +44 131 650 4130

**TITLE:**

EU State Aid Policy and the Politics of External Trade Relations

**ABSTRACT:**

European Union (EU) state aid policy has an oft-overlooked but politically-charged external dimension that is most clearly witnessed in the linkage with external trade relations. The paper seeks to illuminate the issues and potential problems raised by this state aid-trade linkage. When this linkage is made, the EU engages in an array of complex international interactions through which it may pursue two politically-contentious procedures: countervailing duties or dispute settlement. The paper argues that an understanding of the EU's role in these complex interactions must take into account the Union's institutional landscape and the competing preferences of different private interests. When deciding to impose countervailing duties against foreign state aids (subsidies), private interests play a significant role in initiating investigations and can use their access to EU institutions to encourage the imposition of such measures. While a variety of factors help to explain why the EU prefers pursuing countervailing duties, the Union also actively uses the World Trade Organization's formal dispute settlement mechanism. Under this alternative, private interests again play an important role, pursuing varying strategies depending on their preferences. The most important determinant of a firm's preference to pursue countervailing duties or the dispute settlement mechanism appears to be the extent to which the firm is concerned with restoring competition in their home market or with restoring competition in multiple/global markets.

**KEYWORDS:** countervailing measures, European Union, state aid, subsidies, World Trade Organization

**JEL CLASSIFICATION:**

0D21, 0D40, 0D72, 0D78, 0F02, 0F13, 0F23, 0F53, 0F55, 0F59, 0K21, 0K33

## **1. Introduction**

While scholarly work is increasing on the external dimensions of European Union (EU) competition policy, state aid remains relatively under-scrutinised in this academic literature. Such an oversight may be understandable given that state aid policy is directed at the intra-community activity of EU member states and firms, and the EU does not possess the authority to oversee or control the various forms of state aid that may be provided by foreign governments to their own firms. As a result, most scholars investigating state aid confine their queries to what the EU considers state aid, which limits the analysis to the intra-community dimension.

Despite the apparent disconnect with external activities, this paper argues that EU state aid policy does have important external consequences for non-EU firms, governments and consumers. Focusing on the intra-community dimension paints an incomplete picture because the EU's external trade policy includes measures broadly associated with state aid activities. This paper seeks to illuminate the extra-community dimension by focusing on the ways in which different actors—in particular, private economic interests—and factors shape the EU's decision-making when state aid and external trade policies interact.

EU state aid is most clearly linked to external trade policy in so far as it affects market access. While the EU has a rigorous state aid control regime, the authorisation of certain types of domestic state aid can act as a barrier to market access and run counter to the international trade rules of the World Trade Organization (WTO). When limited to intra-community activities, state aid control is clearly politically sensitive (Cini and McGowan 2009, 162). But when the trade linkage is made, state aid disputes become internationally contentious and create further opportunities for

politics to influence decision-making and behaviour at the multilateral level. Such disputes give rise to a complex array of international political interactions in which various public and private actors pursue and defend their interests. The complex interactions occur because state aid measures that inhibit market access can be countervailed against under the WTO's Subsidies and Countervailing Measures Agreement and/or brought to the WTO's Dispute Settlement Mechanism (DSM).<sup>1</sup> This international regime, therefore, creates a setting in which decisions and complex interactions become 'confrontational' and highly politically charged (Palmer 2003). The EU is very much involved in these interactions as one of the most active users and primary targets of such measures.

But what are the factors that help to explain how and why the EU addresses the issues arising from the state aid-trade linkage? Under what conditions does the EU decide to pursue such politically-contentious measures? To begin answering these questions, the following analysis provides an understanding of the EU's role in these complex interactions that takes into account the institutional landscape of the Union and the competing preferences of different private interests. In particular, the role of firms is revealed as an important determinant for EU decisions whether to impose countervailing measures or initiate DSM cases.

The paper proceeds in the following manner. The next section identifies the legal context of the state aid-trade linkage in relation to the EU, noting especially the potential for state aid policy to act as a barrier to market access. Section three describes the most important legal aspects of the WTO's controls on subsidies and countervailing measures. The section highlights the potential clashes that may arise

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<sup>1</sup> While the EU uses the term 'state aid', the WTO uses the term 'subsidy'. Although these two terms share similarities, their precise meanings differ in EC and WTO law. Despite these subtle differences, the terms are often used interchangeably. As this paper is more concerned with the political issues and problems that arise from the state aid-trade linkage, it does not engage extensively with the legal discussion of comparative definitions of state aids and subsidies.

due to differences between the EU and WTO regimes. The fourth section discusses the complex interactions and factors that play a role in the political decision-making associated with the state aid-trade linkage. In particular, the EU's institutional landscape and the role of private interests are highlighted as important elements in the decision to countervail against a subsidy and/or bring an offending measure to the WTO's DSM. The paper concludes with a summary of the findings.

## **2. The State Aid-Trade Linkage in the EU Context**

The Treaty on the Functioning of the European Union (TFEU) states that “any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market” (Article 107(1)). This Treaty article is important for its clear identification of the impact that state aid can have on trade *within* the EU. The objective of EU state aid control is, therefore, to ensure that government aid does not distort intra-community competition and trade.

State aid is defined as “an advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities” (European Commission 2010a). Because state aid must be conferred on a selective basis, subsidies granted to individuals or general measures available to all firms are not considered state aid. For a state aid to exist, the following four basic criteria must be met: (1) there has been an intervention by the state or through state resources which can take a variety of forms (e.g. grants, interest and tax relief, guarantees, government holdings of all or part of a company, or the provision of goods and services on preferential terms, etc.); (2) the intervention confers an advantage to the recipient on a selective basis, for example to

specific companies or sectors of the industry, or to companies located in specific regions; (3) competition has been or may be distorted; and (4) the intervention is likely to affect trade between member states (European Commission 2010b).

Under Article 108, the European Commission is authorised to monitor and enforce state aid control. EU law requires that planned state aid be subjected to an *ex ante* assessment by the Commission prior to implementation. While the Treaty lays down a general prohibition on state aid, the relevant articles (Article 107(2-3)<sup>2</sup>) go on to identify a number of circumstances in which state aid is or may be authorised as compatible with the common market and, therefore, exempt from the strictures of Article 107(1). The potential for conflict between these exceptions and international trading rules is not addressed in the Treaty.

Within the Commission, state aid control is primarily enforced by the Directorate General (DG) Competition.<sup>3</sup> However, if state aid policy becomes linked to trade issues, DG Trade, which is concerned with trade *outside* the EU, becomes involved in the decision-making. This linkage can occur in two ways. First, state aid granted within the EU (even that which meets the Treaty strictures) can run counter to the international trading rules agreed and monitored within the WTO. This aid can act as a barrier to market access for competitors from non-EU countries that do not enjoy similar competitive advantages. Second, state aid granted to foreign firms by other countries can act as a barrier for European firms to enter a foreign market by artificially pushing down the costs of aid recipients in that market. In both of these instances, DG Trade has a direct interest and role to play vis-à-vis EU state aid policy. Indeed, trade representatives in all states have direct interests and roles to play under such circumstances because, by offering advantages to local companies, EU and non-

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<sup>2</sup> See also, Commission Regulation No 800/08 declaring certain categories of aid compatible (General block exemption Regulation).

<sup>3</sup> For other DGs with state aid responsibilities, see Cini and McGowan (2009, 164).

EU state aids can impede international competition and damage the trading interests of European and foreign firms.

State aids can also act as barriers to market access in so far as they limit the transparency needed for commercial decision-making. From DG Trade's perspective, foreign "state aids create an uncertain trading and investment environment, making it difficult for European firms to take sound commercial decisions" (European Commission 2010c). This uncertainty is directly related to a lack of transparency about the size (amount and duration), scope (selected companies in a sector in a foreign country or the whole industry), instruments (direct grants, subsidised loans, tax breaks, subsidised inputs like energy, etc.) and the grantor (central and local government, publicly-owned banks, etc.) of state aids (European Commission 2010c). From the perspective of its trading partners, EU state aid can create a similarly uncertain and possibly unfair environment for trade and investment, which would make it equally difficult for their firms to take sound commercial decisions.

State aid policy is, therefore, closely linked with external trade policy due to its potential to raise barriers to market access, whether by directly supporting competitive advantages for domestic firms or by indirectly disadvantaging foreign firms through a lack of transparency. In both instances, the EU's state aids can function as an impediment to the trading interests of other states while, at the same time, the EU can be harmed by the state aids granted by other states to their own domestic firms. The paper now turns to the international trading rules that apply to this linkage between state aid and market access issues.

### **3. The State Aid-Trade Linkage in the WTO Context**

The WTO's rules on subsidies are primarily contained in the Agreement on Subsidies and Countervailing Measures (SCM), which was negotiated as part of the Uruguay Round. According to Article 1.1 of the SCM, a subsidy shall be deemed to exist if it satisfies three basic criteria: a subsidy is (1) a financial contribution (2) by a government or any public body within the territory of a WTO member (3) which confers a benefit. Whether these three elements are satisfied is determined through processes initiated by WTO members and often brought to the WTO's system of dispute settlement (see below). The SCM covers subsidies granted for goods not services.

Two types of subsidies are identified under the SCM Agreement: prohibited and actionable. The former are further categorised as export subsidies (contingent upon export performance) or import-substitution subsidies (conditional upon the use of domestic goods). Both of these types of prohibited subsidies are identified by the fundamental conditions attached to the subsidy. The latter, actionable subsidies, are defined not by the conditions attached, but by their effects—they must cause adverse effects on the interests of another WTO member. Prohibited subsidies must be withdrawn while actionable subsidies must either be withdrawn or their adverse effects must be removed (Articles 4.7 and 7.8).

In accordance with the SCM, a number of responses are available to WTO members who suspect existing foreign subsidies are either prohibited or actionable. These responses fall under the so-called Track I and Track II procedures.<sup>4</sup> Under

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<sup>4</sup> Beyond Tracks I and II, two other instruments may be employed by a state responding to foreign subsidies: matching and retaliatory subsidies. Matching subsidies (as identified in the OECD Agreement on Guidelines for Officially Supported Export Credits) are enacted to offset the harm inflicted by foreign subsidies. Retaliatory subsidies are enacted with the intent to pressure another state to withdraw its own offending subsidies. The use of either of these instruments may be challenged as "prohibited or actionable under Track II or countervailable under Track I if the relevant conditions are



Track I, a WTO member can impose a countervailing duty (CVD) on imports from another member that grants a prohibited or actionable subsidy that harms the former's domestic industry. The SCM establishes procedural requirements that must be respected before a member can impose a CVD. The appropriate authorities in the harmed member must conduct a detailed investigation following either a decision to self-initiate or the submission of a complaint by the domestic industry producing the like product that has been harmed. A CVD can then be imposed if the investigation establishes "the existence of a (prohibited or actionable) subsidy; injury to the domestic industry; [and] causation between the two" (Ehlermann and Goyette 2006, 711).<sup>5</sup> The CVD is to be notified to the WTO and normally imposed for a duration of five years.

Under Track II, a WTO member can pursue a subsidy complaint through the Dispute Settlement Mechanism (DSM). A member that believes a CVD imposed (under Track I) on its imports contravenes the SCM Agreement may also bring a challenge for adjudication before the DSM. When a complaint is brought to the DSM, the parties to the dispute are encouraged to negotiate a solution. Failing resolution through negotiation, the offending member is subjected to Panel scrutiny and, on appeal, a decision by the Appellate Body. Including an appeal, the DSM timetable allows for approximately one year and three months, although this schedule is flexible and can take longer depending on the duration of negotiations. If the subsidy in question is found to be in violation of the WTO rules, the offending member must bring its policy in line with the ruling. Ultimately, if the offending member does not

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fulfilled" (Ehlermann and Goyette 2006, 712). As neither of these two instruments is formally recognised in the SCM Agreement, they remain outside the scope of this study.

<sup>5</sup> The rules for determining whether a product is subsidised do not always provide for a clear and easy calculation (WTO 2010a). For example, see Palmetier (2003, 155-156) for a discussion of the problems that can arise due to different EU and US methodologies for calculating whether subsidies exist.

change its policy, the complainant is authorised to retaliate with limited trade sanctions (Wolf 2005, 79).

Despite some similarities, differences between the WTO's treatment of subsidies and the EU's system for state aid control can lead to significant problems. First, unlike in the EU system, there is no ex ante control of planned subsidies in the WTO. Rather, WTO members must exercise "self-discipline, and other Members can either impose countervailing duties to counter their effects on their domestic market under Track I or challenge the subsidies granted under Track II" (Ehlermann and Goyette 2006, 696). This exercise of self-discipline can be particularly problematic when states face strong pressure for action from aggrieved domestic interests. The WTO system of ex post facto assessment also increases the unpredictability of dispute outcomes: "Potentially problematic subsidies in the WTO are only subject to (poorly enforced) notification requirements, to (inconsistent) challenges by governments (often acting on private parties' behalf, it is true) under Track II, and to countervailing duties under Track I. The practical consequences of the WTO disciplines are therefore relatively unpredictable" (Ehlermann and Goyette 2006, 717). This unpredictability is often rooted in complex political interactions in a multilateral system that "allows for side-payments, trade-offs and even the continuous unchallenged application of WTO-approved countervailing measures" (Wolf 2005, 98).

Second, problems may arise in relation to the EU's different treatment of certain types of state aid. WTO rules do not provide for exceptions of certain types of subsidies—all measures that meet the three basic elements of a subsidy are in violation of the SCM. However, as mentioned above, the EU allows for certain types of state aids to be authorised as compatible with the common market (Article 107(2-3)). When deciding whether to authorise such aid, the Commission is required to

consider the potential detrimental effects on intra-community trade, not international trade. As the legal scholars Ehlermann and Goyette argue, this scenario creates “a real risk of conflict with WTO law”, noting three areas of particular concern:

- Aid authorised on the basis of Article 107(3)(a), such as ad hoc regional aid to large investment projects: given that they concern large investment projects, such aid, where provided to undertakings exporting to the world market, are likely to cause adverse trade effects.
- Aid authorised on the basis of Article 107(3)(b), i.e. aid to promote the execution of an important project of European interest, such as aid for Airbus.
- Aid authorised under Article 107(3)(c), such as ‘rescue and restructuring aid’: such aid would seem to offer the greatest danger of a reaction by the EU’s international counterparts as aid to firms in financial difficulties will often take the form of operating aid – which a priori has the potential of causing adverse trade effects (2006, 705).

There is, therefore, a significant potential for clashes between the EU’s internal system for controlling state aids and the WTO’s international system for controlling subsidies. The differences between the two systems and the unpredictability of the WTO system all increase the likelihood that political considerations will be injected into the state aid-trade linkage. As Wolf argues, “the whole area of dispute settlement continues to be part of a larger process of strategic bargaining” in which national interests and power politics matter (2005, 112). While there is a greater degree of certainty for EU firms and member states in the Union’s internal state aid system, the European Commission must be cognizant of the external implications of its state aid policy. Likewise, the EU and other WTO members must

calculate the legal and political responses that will be generated by pursuing an offending subsidy under both Tracks I and II. The ways in which the resulting series of complex interactions—including various actors involved in domestic decision-making and international negotiations—are managed within the larger process of strategic bargaining help to determine the nature and extent of problems for the external dimension of EU state aid.

#### **4. The Politics of Linkage at the WTO**

Within the uncertain and complex series of international legal and political interactions, the EU has taken both offensive and defensive positions under the SCM. Offensively, the EU uses trade policy—Track I and II—to counter foreign subsidies. Defensively, the EU defends its state aid against foreign Track I and Track II initiatives. The following discussion focuses on the political factors that play an important role in decision-making when the EU is in the offensive position, in particular, the factors that determine whether the EU will pursue Track I or II.

As the subject discussed herein is linked to the politics of trade policy, it is useful to begin by investigating insights provided by the political science literature on EU trade policy. Within the day-to-day politics of EU trade policy-making (as opposed to multilateral trade round negotiations), what factors and actors may account for EU offensive decisions related to the state aid-trade linkage? According to Dür, private economic interests may play an important role in EU trade policy-making due to their “first-rate access to decision-makers on trade policy issues” (2008, 38). Shaffer agrees, arguing that in the day-to-day politics associated with the WTO DSM, government officials “strive to establish better working relations with industry on trade matters. As a result, the EU’s decision-making process for the investigation,

litigation and settlement of trade claims has become a dynamic, ad hoc, hybrid, multi-tiered process in which private interests are deeply implicated” (2006, 832). These private interests, however, do not share uniform preferences. Rather, trade policy can be conceived as a battle between competing private economic interests from different sectors with differing preferences.

The SCM Agreement opens two different avenues for these competing private economic interests to enter into the EU’s decision-making process: subsidies can either be countervailed (Track I) or subjected to the DSM (Track II). Therefore, the access points for private interests and the potential ways in which the EU may take private interests into consideration should be investigated within the context of EU offensive decisions to pursue Track I and II cases. When an alleged harmful foreign subsidy is identified, the EU authorities may self-initiate a case, but private interests may also submit a complaint that will initiate a case. While Council Regulation 659/99 allows any interested party to provide the Commission with information regarding alleged unlawful state aid, Council Regulation 3286/94 allows “Any natural or legal person, or any association not having legal personality, acting on behalf of a Community industry” which has suffered as a result of obstacles to trade (eg, foreign subsidies) to “lodge a written complaint” (Article 3). Thus, private interests can play a significant role and increase pressure by initiating investigations that could lead to either Track I or II. The paper now turns to an exploration of some of the factors that shape EU political strategies and the processes of decision-making that may account for variation in choosing between the two tracks.

#### **4.1. Track I**

The political science literature has surprisingly little to say specifically about the role of private interests and the politics that shape EU decisions to pursue CVDs under Track I. Those who have investigated CVDs and other such trade instruments emphasise the important role for private economic interests as initiators of cases. For example, Woolcock argues that when the EU decides to pursue anti-dumping measures, “sector interests are almost always the initiator of policy... In the first instance, an industry which believes it is suffering from dumped imports will approach the Commission and probably a number of key member-states to seek anti-dumping actions” (2005, 242). More generally beyond dumping, Woll agrees with this contention, arguing that “All of these administrative instruments require the identification of unfair competition practices, for which firms often have better information than governments. Over time, the EU has therefore tried to facilitate business input, so as to identify the greatest possible number of trade barriers or obstacles to competition” (2009, 282). Therefore, due to their right of initiative, access to information and the Commission’s institutional openness, private interests can increase the likelihood of pursuing trade instruments such as CVDs.

Under the SCM Agreement, the WTO’s subsidy disciplines have been enforced more often through Track I than Track II. If private interests do play an important role in these decisions, it is worth exploring why they would prefer Track I over Track II. Ehlermann and Goyette provide a number of useful insights on the factors that might increase the likelihood of pursuing Track I over Track II. First, the imposition of CVDs will often be sufficient to address the concerns of the affected domestic private interests. Second, imposing CVDs is faster than pursuing a potentially lengthy Track II case through the WTO DSM. While the formal DSM timetable allows for approximately one year and three months, negotiations and

appeals can extend the final ruling considerably. Third, pursuing a CVD may be easier because the EU can impose a CVD “and then await a possible challenge on the part of the Member whose exports have been countervailed. Time (and the burden of proof, which normally falls upon the Party alleging a violation) will then play in the favor of the Member imposing the CVDs” (2006, 712). Fourth, the EU may opt to pursue Track I because the remedies available under unilateral CVDs are more appealing than those available under the Track II multilateral rules. The multilateral rules “do not affect subsidies that have been granted in the past... at least under the prevailing opinion – there is no repayment of subsidies violating the SCM Agreement provisions. Countervailing measures, on the contrary, will grant some remedy against past subsidies: subsidies may be countervailed as long as the benefit they conferred persists” (2006, 713).

The large number of Track I CVD cases pursued by the EU suggests that private interests are keen to reap the multiple benefits associated with this type of trade instrument. From 1995-2009, the EU initiated 54 CVD investigations and implemented 25 countervailing measures. Only the US initiated more investigations (102) and implemented more countervailing measures (60). After the EU, the next most active WTO member during that period was Canada, having initiated 24 investigations and implemented 15 countervailing measures.<sup>6</sup>

Private interests are able to play an important role in these decisions to pursue a CVD case simply by submitting a complaint and initiating an investigation. Beyond initiating an investigation, private interests can then use their access to information and the EU’s institutional openness to pressure the Commission and member states to

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<sup>6</sup> The data comes from the semi-annual reports of WTO members to the Committee on SCM Practices (WTO 2010b). In the defensive position during the same period, the EU has been investigated 11 times and had countermeasures implemented against it 9 times, ranking it well below front-runners India and China.

impose countervailing measures. The numerous and appealing advantages associated with Track I—including its ability to satisfy domestic concerns, increased speed, greater ease, and better remedy against past subsidies—help to explain why private interests would frequently pressure the EU to pursue such a large number of CVDs.

#### **4.2. Track II**

Tensions and disagreements that arise from the state aid-trade linkage can also be resolved through Track II recourse to the WTO's DSM, the timetable for which focuses the parties' attention and encourages a negotiated solution. Regarding the EU's potential usage of the DSM, Young argues that the EU's core strategy "is giving the respondent... a reasonable amount of time to comply before the sanctions are imposed" (2006, 201). Such a political strategy allows the defendant to use the element of time in its favour, taking an indeterminate "reasonable amount of time" to negotiate removal or amendment of the offending trade measure before the EU imposes sanctions.<sup>7</sup> This strategy stands in stark contrast to that employed under Track I, where CVDs are much more immediate and direct responses that allow the EU to use the element of time in its favour. While the EU has undertaken this strategy less frequently than Track I, from 1995-2009, it has pursued this strategy 19 times by citing the SCM when formally requesting the initiation of consultations within the DSM framework.

So, why would the EU ever use the Track II DSM if the element of time favours the defendant under such a procedure? In the broader international context, the EU may view opting for Track II as politically advantageous. By bringing the case to an independent arbiter (the WTO), the EU may be seen by its trading partners as

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<sup>7</sup> For the formal understanding of a "reasonable amount of time", see Article 21 of the WTO's Understanding on Rules and Procedures Governing the Settlement of Disputes.



pursuing a less confrontational course of action than if it had implemented a Track I CVD. Playing such an apparently self-disciplined and cooperative role may enhance the EU's prospects when negotiating future trade agreements or reduce the likelihood that it will be targeted for Track II complaints by other WTO members. However, due to the fact that the EU decides to pursue Track I so often, any such benefits are likely to be minimal and fleeting.

The general institutional landscape of EU decision-making in trade disputes seems to provide better answers for why the EU would pursue Track II. The EU may pursue a trade dispute in the DSM due to the relative ease of obtaining the support of its own member states in such cases. According to Young,

Finding a qualified majority of member governments to support the initiation of a trade dispute, contrary to some of the concerns in the literature, is actually relatively easy. First, opposition to initiating a trade dispute from another economic actor is rare. Second, the EU's member governments tend to object to a trade policy objective only if their interests are directly negatively affected. These two political dynamics together help to explain why the decision to initiate [DSM] complaints has been relatively uncontroversial (2006, 198).

Thus, the institutional obstacle of a vote does not often act as a significant hindrance to the political decision to pursue a Track II case because the need for a qualified majority is relatively easy to attain. However, due to the access enjoyed by private interests, firms also play a prominent role in the decision-making process and, as shown above, they have good reason to prefer the pursuit of a CVD. To begin understanding this apparent contradiction, we need to explore the strategies of competing private interests in relation to the decision to bring a case to the DSM.

First, firms not directly involved in initiating the case may be passive. These firms do not view the initiation of a case as having any significant implications for their interests. As a result, they neither oppose nor support the initiation of a case. This passivity may also be due to the fact that the imposition of WTO sanctions is rare and that “the composition of the sanctions, and thus which domestic firms would be adversely affected, is not known when a complaint is initiated” (Young 2006, 198). Under such circumstances, “the initiation of a trade dispute is... characterized by a political dynamic of non-interference; there is no opposition from other firms” (Young 2006, 198). If at any point the firms determine that a particular case may affect their interests, they may shift their behaviour to a more active strategy of opposition or support.

Second, firms not directly involved in initiating the case may also undertake a more active strategy of opposition. For example, private interests may “benefit from the foreign [subsidy]... by having an investment in or by being major suppliers to the protected foreign industry” (Young 2006, 199). Under these conditions, a firm’s overseas operations could be significantly harmed by a trade dispute that ultimately results in the removal of those foreign subsidies that contribute in some way to its business. Such firms can be expected to undertake a strategy to oppose the decision to bring a case to the DSM as a way to reduce uncertainty for their overseas operations.

Third, a different strategy can be expected from firms directly involved in initiating a Track II DSM complaint. By actively supporting the initiation of a complaint, these firms reveal an obvious interest in removing the offending foreign subsidy and the alleged unlawful benefit it confers. This strategy raises the question of why these firms would opt for Track II over Track I, especially given the unpredictability of the WTO dispute system and the advantages of pursuing CVDs.

Specifically in cases of subsidies, Ehlermann and Goyette note the most likely reason why private interests may actively support the decision to opt for Track II:

First and foremost, this will be the case where the national industry is not so much concerned about the effect of subsidies on its home market (in which case CVDs can be sought and imposed), but where the effect of the subsidies is felt either on third country markets or even on the markets of the WTO Member granting the subsidy. In such cases, recourse to WTO dispute settlement will become a necessity. This reasoning is reflected in the experience of WTO dispute settlement to date. Most cases that have made it to WTO dispute settlement were motivated by a desire to restore the competitive playground on a global scale, as opposed to merely preventing subsidies from flooding the home market (Ehlermann and Goyette 2006, 712-713).

Thus, while Track II is less frequently used, it still offers advantages over Track I under certain conditions. The most important determinant of a firm's preference for Track I or II appears to be the extent to which it is concerned with restoring competition in the home market or restoring competition in multiple/global markets. When concerned with restoring competition simply in the home market, CVDs will suffice. When concerned with restoring competition in multiple/global markets, recourse to the DSM will be necessary.

The Boeing-Airbus WTO dispute provides a useful example that conforms to these assertions regarding the concerns of private interests. Although EU state aid to Airbus may have been permissible as a 'project of European interest' under TFEU Article 107(3)(b), the US viewed such subsidisation as a violation of WTO rules. After lengthy negotiations and the launch of formal consultations in 2004, the US

filed a formal complaint with the WTO in May 2005, with the EU immediately filing a counter complaint against US federal and state subsidies to Boeing. While the EU reacted immediately, it had undertaken careful internal deliberations with private interests before issuing its counter complaint.

In accordance with the logic presented above, the private interests in the EU supported the initiation of the WTO dispute because they were particularly concerned with restoring competition in multiple and/or global markets. The evidence supports this assertion. The civil aircraft market is a global market with a large number of customers (ie, airlines). Moreover, the global market for aircraft with more than 100 seats is characterised by a duopoly of supply: Airbus and Boeing are the dominant manufacturers of similar civil aircraft products. Clarifying the Airbus position, the company's chief executive Tom Enders stated in 2008, "Our issue is not state aid per se, our issue is to create a certain balance with the state support the competition receives... For ages, we have demanded nothing other than what actually goes without saying: namely the so-called level playing field with our American competitors" (Reuters 2008). The playing field that needed leveling was the global market for civil aircraft. Given the concern over competition in this global market, Airbus and its related businesses would not have been satisfied with pursuing a CVD and its associated advantages. Only a Track II dispute would hold the potential for addressing the nature of competition between these duopolists and restoring competition in the global civil aircraft market, a market in which Airbus plans to remain active in the foreseeable future.

In sum, the initiation of a trade dispute in the DSM is relatively easy for the EU—a qualified majority of member states is likely to exist, especially when opposition is weak from private interests that are uncertain about the immediate or

future adverse affects. Competing private interests can, however, also play a more active and important role in the decision to pursue Track II. On the one hand, when they are not directly involved in initiating the case and benefit from an offending foreign subsidy, private interests in the EU are likely to oppose the initiation of a DSM case. On the other hand, when they are competitively disadvantaged in a third country or global market by a competitor who enjoys a foreign subsidy, private interests in the EU are likely to support the initiation of a DSM case. When choosing between the two Tracks, these active supporters are more likely to prefer the DSM (Track II) if they are more concerned with restoring competition in multiple/global markets than with restoring competition in the home market.

## **5. Conclusions**

This paper argues that, despite often being overlooked in the competition policy literature, EU state aid control has an important external dimension beyond its more familiar intra-community dimension. In particular, the external dimension is evidenced by a linkage between the EU's state aid and external trade policies: the implementation of state aid policy can raise barriers to market access. This linkage with external trade policy gives rise to a complex array of political interactions across domestic and international levels. The paper provides an investigation into a number of issues and potential problems associated with this linkage and explores the ways in which different domestic and international factors and actors shape the EU's decision-making in this area.

A number of differences exist between the EU's state aid control system and the WTO's Subsidies and Countervailing Measures Agreement. These differences and the unpredictability of the WTO system all increase the likelihood of confrontational

and highly politically-charged interactions. In particular, while the WTO does not provide for exceptions to certain types of subsidies, the EU may authorise certain forms of state aid as compatible with the common market. These EU exceptions can be particularly problematic when they include ad hoc regional aid to large investment projects, aid to promote important projects of European interest and aid for rescue and restructuring.

The EU has become an active player in the complex politics of linkage at the WTO. Under the SCM Agreement, two different offensive approaches can be taken for controlling subsidies: Track I countervailing duties and Track II dispute settlement. This paper argues for the importance of investigating the EU's institutional landscape (eg, authority to initiate, openness to access, and qualified majority voting rules) and, in particular, the role of private interests for understanding variation in decisions to pursue either Track I or II.

In the decision to impose countervailing duties under Track I against foreign subsidies, private interests play a significant role by initiating investigations and can use their institutional access to both the Commission and member states to encourage the imposition of such measures. The EU and its firms prefer pursuing countervailing duties for a number of reasons, including their likelihood of satisfying domestic interests, increased speed, greater ease, and better remedy against past subsidies.

The EU also actively uses the WTO's formal DSM under Track II. The Union's institutional landscape and private interests again play an important role. Under the EU's institutional decision-making procedures, finding a qualified majority of member states to support the initiation of a dispute is relatively easy. For their part, private interests may be passive or pursue more active strategies of opposition and support. Only when private interests in the EU benefit from an offending foreign

subsidy, are they likely to oppose actively the initiation of a DSM case. When they are competitively disadvantaged in a third country or global market by a competitor who enjoys a foreign subsidy, private interests in the EU are likely to support actively the initiation of a DSM case. When choosing between the two Tracks, private interests are more likely to prefer the DSM (Track II) if they are more concerned with restoring competition in multiple/global markets than with simply restoring competition in the home market.

The linkage between state aid and external trade policy presents a rich research agenda for scholars interested in competition policy and the European Union. Further research on the complex domestic-international interactions associated with this linkage is also likely to inform policy-makers. Given the current global economic situation, growing demand within the Union for state aids may lead to increasing disagreements with other WTO members over the EU's obligations under international trade rules. Likewise, the EU may find itself facing greater internal pressure from firms that are increasingly disadvantaged by foreign subsidies to initiate CVDs and DSM cases. As a result, the competition regulator and the trade negotiator must become increasingly aware of potential clashes between their respective policies, objectives and obligations.

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